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Brazil: A Strategic Role for Exports

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An Intelligence Assessment

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*ALA 84-10108
November 1984*

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Erratum

Notice to recipients of Intelligence Assessment: *Brazil: A Strategic Role for Exports*, ALA 84-10108, C [] November 1984.

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On page 6, replace the inset material under the heading "Brazil's Arms Sales" with the attached inset.

Brazil's Arms Sales

In a little more than a decade, Brazil has emerged as the world's eighth-largest weapons exporter. Frequently, this role has been the subject of strong criticism at home and abroad and of considerable controversy within the Brazilian Government. Brasilia has not publicized comprehensive details of its weapons exports because of the political sensitivity of these transactions. Official Brazilian trade statistics, for example, identify \$300 million of weapons exports in 1983 but, by the admission of Brazilian trade officials, do not include major and expensive items such as light aircraft and wheeled armored vehicles. With the aggregative value of overseas arms sales agreements rising sharply in the early 1980s to a record \$1.3 billion last year, we judge that actual exports probably have increased also to a 1983 total value considerably higher than the \$300 million publicly acknowledged. We estimate that arms sales accounted for 3 to 4 percent of total export revenues over the past three years. []

grandeza, or great-power status. Brazil has relied heavily on Arab customers both for arms purchases and investment capital. Until this year, Iraq and Libya alone absorbed well over half of Brazil's arms exports. More recently, the Brazilian Government appears to be restraining its sales to Libya out of irritation with Tripoli's support for terrorism and is cultivating new customers in the region, particularly Saudi Arabia and Algeria. Also, the cooperative ventures financed by Iraq and other Arab states in recent years have allowed Brazil to push forward with new weapon systems such as modern tanks and multiple rocket launchers, in part by giving the Arab purchasers a strong voice in determining the specifications of the weapons to be developed. Because the government is aware that its concentration of deals with the Middle East makes Brazil vulnerable to any sudden cut in the region's demand, it is also beginning to diversify its markets in Latin America and Africa. []

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Brazil uses arms exports to increase its international trade surplus, to strengthen its relations with Third World states, and to advance its drive toward

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Brazil: A Strategic Role for Exports

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An Intelligence Assessment

This assessment was prepared by [redacted] Office
of African and Latin American Analysis. It was
coordinated with the Directorate of Operations.
Comments and queries are welcome and may be
directed to the Chief, South America Division,
ALA, [redacted]

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**Brazil:
A Strategic Role
for Exports**

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Key Judgments

*Information available
as of 1 October 1984
was used in this report.*

Brazil is counting heavily on rapid export growth to overcome its debt payments crisis and lead an economic recovery. It has prepared the ground for such growth by establishing itself over the past 20 years as a major supplier worldwide of a broad range of industrial and primary products. During the debt crisis of the past two years, the Brazilian Government has taken several important steps—most notably aggressive exchange rate adjustments—to promote a resurgence in exports. On the basis of statistics to date, we expect that Brazilian export earnings this year, largely reflecting rising US demand, probably will show a robust increase of at least 20 percent over last year to reach some \$26.5 billion.

We believe Brazilian exports probably will register another good, though less dynamic, performance in 1985—probably reaching \$29 billion—despite some significant emerging challenges. The United States, with its large current account deficit and likely prospects for slower growth, probably will not continue to increase its imports from Brazil at the current pace. Prospects are good, however, that exports to non-US markets, especially to Europe and Asia, will accelerate as a result of a shift in the industrialized country recovery from the United States to Western Europe and a decline in the value of the US dollar—to which the cruzeiro is linked—against other major currencies.

Moreover, the new civilian government that takes power in Brazil next March will face domestic pressures for a growth strategy more oriented to the domestic market than one based on large export increases, although it probably will not yield to such pressures more than marginally. The US Embassy views both presidential candidates as pragmatic leaders who fully appreciate the importance of correcting economic imbalances and maintaining foreign creditor support. A 10-percent export increase, which we judge is possible, should permit Brazil to reduce its foreign borrowing needs substantially and to boost its national output at least 3 percent.

Our calculations based on quantitative analysis suggest that, beyond 1985 until the end of the decade, under favorable domestic policy and world economic conditions, Brazil will be able to generate sufficient export growth to meet its interest obligations, restore its creditworthiness, and support politically acceptable rates of economic growth. To repay its debt principal, Brazil will continue to require some rescheduling or new borrowing. Manufactured goods would probably lead the export advance.

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We judge that exports of automobiles, metals, and machinery will continue to rise at a fast clip. Other consumer items that have yet to penetrate foreign markets in significant amounts, ranging from handicrafts to high-technology products, will make further major contributions. Large investment projects of the past decade that are coming into operation—including grains from the central plains and metal ores from the Amazon—also will help shore up gains for primary product exports.

We believe a successful Brazilian export drive would come at the expense of some US and Third World exporters. A heightened Brazilian sales drive in third-country markets will present stiffer competition for a wide range of US exports, ranging from soybeans and frozen chicken to small aircraft. Other major Latin and Third World debtors, now encouraged by international creditors to export their way out of debt, would also be affected by a surge in Brazilian industrial and commodity exports.

We see a sizable risk, nevertheless, that global economic conditions may deteriorate sometime in the next few years—precipitated most likely by rising interest rates and a collapse of the recovery in the industrialized countries. Under such circumstances, the new civilian president might shift Brasilia's policy course from export-led adjustment to major domestic expansion. The resulting smaller export gains would reduce Brazil's foreign exchange earnings well below its debt payment commitments. In that event, bank creditors probably would balk at requests for new loans and dramatic debt restructuring, and Brazil's financial position would unravel perilously.

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Table 1
Brazil: Composition of Exports

Million US \$
(except where noted)

Item	1964	Percent of Total	1974	Percent of Total	1981	Percent of Total	1983	Percent of Total
Total	1,430	100.0	7,950	100.0	23,295	100.0	21,900	100.0
Soybean and products	5	0.2	890	11.2	3,190	13.7	2,565	11.7
Coffee	760	53.1	980	12.3	1,760	7.6	2,325	10.6
Iron and steel products	15	1.0	165	2.1	1,125	4.8	1,670	7.6
Iron ore	80	5.6	570	7.2	1,735	7.5	1,520	6.9
Transport equipment	10	0.5	185	2.3	2,065	8.9	1,445	6.6
Boilers, mechanical machinery	5	150	150	1.9	1,545	6.6	1,095	5.0
Footwear	NEGL		120	1.5	585	2.5	715	3.3
Orange juice	NEGL	0.1	60	0.7	660	2.8	610	2.8
Beef	15	1.2	110	1.4	420	1.8	515	2.4
Sugar	35	2.3	1,320	16.6	1,060	4.6	515	2.4
Organic chemical products	NA	NA	NA	NA	425	1.8	515	2.3
Petroleum fuel oils	5	0.2	35	0.4	365	1.6	475	2.2
Tobacco	30	2.0	100	1.2	355	1.5	460	2.1
Electrical machinery and appliances	NEGL	0.1	185	2.3	565	2.4	440	2.0
Other	475	33.1	3,080	38.7	7,435	31.9	7,035	32.1

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Brazil: A Strategic Role for Exports

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Introduction

Rapid expansion of exports is becoming increasingly crucial to Brazil's ability to meet its huge foreign debt obligations and launch a recovery from its prolonged and socially unsettling economic recession. A major contraction of capital inflows since 1982, mainly reflecting Brazil's reduced creditworthiness, has put a considerable burden on the country's trade surplus to meet rising debt payments. Because imports have been slashed to near irreducible levels and soon will need to rebound to support a domestic economic recovery, the task will fall entirely to exports to sustain these surpluses.

A Brazilian export drive, however, will likely face foreign demand conditions—because of both market weaknesses and protectionist sentiments—that are less favorable than in earlier decades. The policy commitment to exports of the new civilian administration, scheduled to take office in early 1985, may be tested by pressures from advocates of a more nationalistic growth strategy that is oriented toward the domestic market. The interplay of these factors on Brazil's export record over the next few years will have considerable impact on its economy as well as on US and other foreign banking, investor, and commercial interests.

The Nurturing of an Export Policy

Exports have assumed an unprecedented and major importance to Brazil's economy since 1964, when the armed forces took control of the government in the midst of an acute foreign payments crisis. To encourage export growth, the government introduced a series of incentives, including simplified administrative procedures, tax breaks, subsidized credits, and competitive pricing through exchange rate and wage policies. The resulting surge in export earnings was impressive. A 25-percent annual rise in exports during the years 1968-73 was a key factor in spurring annual real GNP growth of 11 percent during Brazil's so-called

Transformation of Brazil's Exports

In the past 20 years, Brazil has transformed itself from a predominant coffee exporter into a major competitor in the world marketplace for sales of a diverse array of products. Brazilian statistics show that, although sales of primary products continued to rise in value, most of the export expansion was driven by manufactured goods. Led by iron and steel, transportation equipment, machinery, chemicals, and footwear, Brazil's manufactured exports soared from less than 15 percent of total exports in 1964 to about 60 percent in the early 1980s. Many new Brazilian exports have emerged and gained footholds in foreign markets, including such items as airplanes, ethyl alcohol, aluminum, military arms, petrochemicals, automobiles, and automation equipment. Brazil also substantially increased the number of countries with which it traded, especially in Asia, the Middle East, and Africa. The less developed countries hiked their share of Brazilian exports from 17 percent in 1964 to 40 percent by the early 1980s, while the share purchased by the industrial countries fell. Communist countries continued to account for a steady 7 to 8 percent of Brazil's exports over the period.

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miracle years. Rising exports over 1974-81 helped pay for massive increases in the cost of imported oil. In that period, an 18-percent annual increase in exports was approximately double the rate of growth of Brazil's oil bill and, together with large-scale borrowing, permitted sizable hikes in nonoil imports as well (table 1).

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Despite the successes, Brazil's exports are vulnerable to jolts to the world economy. Export earnings in 1982 dropped more than 13 percent to \$20.2 billion and posted only a mild rebound to \$21.9 billion in 1983—years when Brazil could ill afford the loss. The contractionary effects of a deep world recession on

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Table 2
Brazil: Major New
Export Growth Products

Million US \$

	1970	1983
Airplanes	0	80
Aluminum	0	110
Ethyl alcohol	0	80
Footwear	8	720
Frozen chicken	0	240
Fuel oils	12	480
Linen products	1	60
Motor vehicles	3	1,130
Orange juice concentrate	15	610
Paper and pulp	6	520
Plastic materials	0	280
Processed soybean oil	1	310

foreign demand were largely responsible, but an overvalued cruzeiro that eroded the competitiveness of Brazilian goods also contributed to the export slide, according to US Embassy reporting. The slippage in export earnings, combined with large increases in interest payments and growing banker reluctance to lend additional money, caused Brazil's international payments position to crumble. By the end of the year, Brasilia was forced to negotiate a large financial rescue package with the International Monetary Fund (IMF) which called for an austerity program requiring not only fiscal and monetary restraint but also a foreign exchange policy more conducive to export growth. []

Strengthening Export Promotion

Beginning in 1983, the Brazilian Government undertook several policy reforms to revive rapid export growth as the way out of its debt crisis, the most important being an aggressive exchange rate policy. To eliminate the overvaluation of its currency, Brasilia devalued the cruzeiro 23 percent against the US dollar in a single action in February 1983. Thereafter, according to US Embassy reports, it depreciated the value of the cruzeiro in line with domestic inflation in a series of smaller increments. The IMF calculated that these actions reduced the cruzeiro's effective real

rate of exchange against a basket of trading partner currencies nearly 20 percent over the course of 1983. Based on Brazilian data, we judge that the aggressive devaluations considerably improved the price competitiveness of Brazilian goods in the United States and several European countries. []

According to press and US Embassy reporting, Brasilia also has increasingly used several fiscal and credit incentives to boost exports, although some others are being dismantled as a result of foreign pressures:

- In March 1983, the administration expanded the number of export-related goods that are exempt from the country's two main value-added taxes. Besides all exported manufactured goods previously exempted, manufactured inputs to products subsequently exported also became eligible.
- The government, in addition, extended a value-added tax credit to firms that export certain designated manufactured goods; it has pledged to phase out this practice in 1985, however, because of charges of unfair trade practices made by foreign competitors.
- The government has sharply expanded use of import tax and duty reductions since 1983—under the Fiscal Benefits for Special Export Programs (BEFIEX)—for certain capital equipment used in the production of export goods.
- The monetary authorities approved in August 1984 a new private-sector-led export financing system to replace an earlier official, low-interest credit program that Brasilia was compelled to slash because of austerity commitments to the IMF. Export credit is now provided by Brazil's banking system with its own resources, although the government will partially cover the higher interest rates to be paid by the exporter.
- The National Bank for Economic and Social Development began disbursing loans in April 1984 under its new Program for Support of Export Expansion (PROEX) to companies that pledge to meet specific export expansion goals over a two-year period. []

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Table 3
Brazil: Overseas Markets

Million US \$
(except where noted)

Country	1964	Percent of Total	1974	Percent of Total	1981	Percent of Total	1983	Percent of Total
Total	1,430	100.0	7,950	100.0	23,295	100.0	21,900	100.0
United States	475	33.2	1,735	21.8	4,115	17.7	4,985	22.8
Japan	30	1.9	555	7.0	1,220	5.2	1,425	6.5
Netherlands	80	5.5	605	7.6	1,470	6.3	1,260	5.8
West Germany	135	9.3	570	7.2	1,315	5.7	1,145	5.2
Italy	70	4.7	355	4.5	960	4.1	985	4.5
France	50	3.6	270	3.4	850	3.7	875	4.0
United Kingdom	65	4.4	375	4.7	735	3.2	720	3.3
Argentina	90	6.4	300	3.8	880	3.8	675	3.1
Soviet Union	35	2.6	135	1.7	620	2.7	640	2.9
Spain	15	0.9	300	3.8	370	1.6	545	2.5
Belgium-Luxembourg	40	2.9	145	1.8	415	1.8	505	2.3
Iraq	0	0	160	2.0	300	1.3	410	1.9
Other	350	24.6	2,440	30.7	10,040	43.1	7,740	35.3

Public and private firms also have adopted more aggressive sales promotion techniques to expand their foreign markets, according to the US Embassy and the press. For example, delegations from Siderbras—the government-owned steel company—have stepped up their travels throughout the world to solicit increased purchases of Brazilian steel products. Private chemical companies have vigorously pushed their sales abroad, partly to offset the impact of diminished domestic sales. []

The US Embassy notes that Brasilia also has been encouraging expanded use of the more than 100 Brazilian export-oriented trading companies, which, because of their network of international commercial channels, are attractive to small companies inexperienced in foreign sales. According to the press, nearly one-third of Brazil's total exports in 1983 was sold by trading companies, compared with 19 percent two years earlier. Interbras, a trading-company subsidiary of the government-owned oil company Petrobras, uses the leverage of its parent company extensively to secure pledges from foreign oil suppliers to purchase large amounts of Brazilian goods and services. []

Recovery Under Way

Brazilian trade returns indicate that the impact of the government's policy initiatives and the gradual economic recovery of the industrial countries reversed the export decline starting in the second quarter of 1983. An 8-percent rise in exports, combined with a large cut in imports, enabled Brazil to attain a \$6.5 billion trade surplus last year, exceeding its IMF program target by \$200 million. We judge from trade data available for the first three quarters of the year that the industrialized country recovery and continued implementation of Brasilia's current policies will almost ensure an export total in 1984 of \$26.5 billion, more than a 20-percent increase from 1983. This impressive export performance should lead to an \$11.5 billion trade surplus—enough to cover net interest obligations for 1984 and to eliminate any need for additional foreign borrowing—while still

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Brazil's Oil Countertrade Initiatives

Brazil's policy is to purchase most of its oil from those countries that reciprocate by importing Brazilian products, according to a high-level spokesman of Petrobras, the government-owned oil company. For this reason, according to press reports, whenever Petrobras negotiates an international oil purchase, its subsidiary, Interbras, participates as part of an effort to secure countertrade agreements. For 1984, we estimate that Brazil will import an average of 650,000 barrels per day (b/d) of crude oil. Of the total, Petrobras has contracted to refine 110,000 b/d of Nigerian oil for reexport. Brazil imports more than half of the remaining 540,000 b/d under oil countertrade arrangements. Interbras's major countertrade agreements have been with:

- *Iraq, its largest oil supplier, to continue providing 160,000 b/d of crude oil valued at \$1.8 billion in return for Baghdad's promise to buy Brazilian beef and manufactured goods worth at least \$600 million.*
- *Iran, to buy 45,000 b/d of crude oil in exchange for manufactured goods sales of equivalent value.*

Flows in both directions, however, dwindled after the escalation of fighting in the Persian Gulf in May.

- *Mexico and Venezuela, each to barter agricultural and manufactured goods for, initially, 60,000 b/d of oil. According to the press, Brasilia subsequently cut its imports from Mexico to 40,000 b/d because of what it considered insufficient reciprocity.*
- *China, for 40,000 b/d of oil in return for shipments of steel, iron ore, and other products.*

Brazil continues to pay foreign exchange to Saudi Arabia, its second-largest supplier, for 130,000 b/d of crude oil, because Riyadh offers concessional prices and terms. By contrast, Brazil recently suspended imports of oil from the United Arab Emirates and Libya because of the failure of the governments of those countries to pledge purchases from Brazil.

permitting a 15-percent rise in nonoil imports. According to Brazilian data, the strength of the export advance also has supported a somewhat narrowly based industrial recovery in 1984 (table 4).

A relatively small group of countries has accounted for the bulk of Brazil's export expansion since early 1983. By far the most important has been the United States, which alone absorbed over half of Brazil's export growth last year and, according to US Commerce Department data, is taking another large share this year. Other important purchasers have been Japan and the oil-exporting countries of the Middle East and Africa. Sales to developing countries in Latin America dropped precipitously in 1983 because of the severe financial disorders in that region, but have started to rebound this year, according to US Embassy reports.

The recent resurgence has been almost entirely attributable to increased sales of industrial goods, the new bulwark of Brazilian exports. Such sales grew 14 percent in 1983 and a booming 39 percent in the first eight months of 1984 from a year earlier. Brazilian trade data indicate a wide range of manufactured and semimanufactured products have shared in the export recovery, although the sharpest gains have been registered by steel products, footwear, chemicals and plastics, orange juice, and engines. Although statistics are unavailable, we suspect, on the basis of known contracts, that arms exports probably have risen as well.¹ In addition, according to the press, the devaluations have enabled a widening range of manufactured

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Table 4
Brazil: Balance of Payments

Billion US \$

	1982	1983	1984 ^a
Current account balance	-16.3	-6.9	-3.0
Trade balance	0.8	6.5	11.5
Exports	20.2	21.9	26.5
Imports	19.4	15.4	15.0
Service balance, net	-17.1	-13.4	-14.5
Net interest payments	11.4	9.6	10.9
Medium- and long-term debt repayments	8.4	8.2	8.8
Gross foreign exchange requirements	24.7	15.1	12.3
Financed by:			
Direct investment, net	2.5	1.3	1.3
Official and supplier credits	3.2	4.7	4.0
Long-term commercial loans	11.5	10.6	12.6
Short-term credits, net	-1.0	-1.3	0.7
Bridge operations, net	4.0	-4.0	0
Others	4.5	3.8	-6.3

^a Projected.

exports to become competitive in foreign markets, including such new but minor items as matchsticks, dentures, razorblades, and bathing caps.

Challenges Ahead

We believe that, unlike 1983 and 1984, the entire burden of generating future large trade surpluses required to finance heavy debt payments probably will fall to export expansion rather than import cuts. Imports were cut 21 percent to \$15.4 billion in 1983 and probably will fall to \$15 billion this year. At that level, imports are only 5 percent of GDP compared with 9 percent in 1980 and more than 15 percent in all other South American countries except Argentina. Some small additional import savings are still possible in the extractive industries. Industry experts believe that petroleum imports may decline from about \$6.3 billion this year to as little as \$5.5 billion annually

Brazil's Exports in 1984

Brazilian producers, facing still-depressed domestic demand, have been taking advantage of greater opportunities to export to utilize idle capacity and enhance earnings. Most of the exports have been absorbed by the expanding markets of the United States and other industrialized countries. Among the products that we believe will register large gains this year are the following:

- *Orange juice exports will be up about \$500 million from last year to \$1.1 billion. Sharply higher prices resulting from the frost-induced devastation to the US orange crop has spurred the advance.*
- *Transportation equipment sales will rise more than \$400 million to about \$1.8 billion. The Brazilian subsidiaries of foreign automakers are substantially increasing their exports of cars, trucks, engines, and vehicle parts to offset the impact of contracting domestic markets. The Brazilian financial press also reports sizable increases in sales abroad of small aircraft.*
- *Coffee exports will expand some \$400 million to \$2.7 billion. Brazilian sales will benefit both from a 10-percent average higher price this year and sharply increased sales to nonmembers of the International Coffee Agreement.*
- *Footwear exports will reach \$1 billion, some \$300 million more than in 1983. Most of the increased sales will occur in the United States, where a recent International Trade Commission ruling rejected appeals by the US shoemaking industry for protectionist measures.*
- *Pulp and paper product sales abroad probably will rise some \$300 million to some \$800 million, largely because of sharply higher exports to the Middle East and Asia.*

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Brazil uses arms exports to increase its international trade surplus, to strengthen its relations with Third World states, and to advance its drive toward

later in the decade as Brazil more fully exploits its domestic energy resources and petroleum prices remain low. Moreover, we expect that the development of new mines will permit some further contraction of copper and aluminum imports. As economic activity in Brazil picks up, however, requirements for nonoil industrial material and machinery imports will more than offset oil and other mineral import reductions. Few major untapped opportunities for import substitution exist in the manufacturing sector, in our judgment. []

External Obstacles

Sustaining export increases needed to meet future debt servicing will not be easy. The United States, with its own \$100 billion current account deficit and prospects for slower growth, probably cannot absorb additional large increases in Brazilian exports. The financial press already indicates mounting pressures from US business and labor groups to limit access for some key Brazilian exports, most notably steel.

Persistent financial problems and depressed economic conditions in Latin America and Africa will likely forestall appreciably higher sales to these regions over the next few years. Brazil probably will be unable to expand substantially its sales to the USSR and other Eastern Europe countries because of the Communists' dissatisfaction with their existing bilateral trade deficits, according to US Embassy reporting. []

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Thus, we judge Brazil will need to look more to markets in Western Europe and East Asia, despite some protectionist sentiments there. For example, major international economic forecasting services project that West Germany, France, and Italy—three of Brazil's half dozen largest markets—will show substantial economic growth and strong import demand. If the value of the US dollar declines against

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European and other currencies, which many financial analysts are predicting, Brazilian goods would become more price competitive in those non-US markets since Brazil tends to link the cruzeiro's value—and adjustments thereto—to the US dollar. []

Brazilian manufactured goods, in our opinion, will need to lead the export advance. Judging from most government and private commodity price projections, Brazil's export drive will not get the considerable help from its primary product sectors that it has in all past export spurts. Conditions of worldwide oversupply in a number of agricultural commodity markets—including coffee, cocoa, and sugar—will inhibit a major improvement in world prices for these goods for some time. With industrialized country demand growing only slowly, we believe that Brazil will need to enlarge its foreign market share through vigorous export promotion. []

The Impact of the Civilians

It is not now predictable how successful the new civilian government scheduled to take office in March 1985 will be in fostering continued export growth. The civilian government, like the present military one, will have fewer export policy options at its disposal than most previous administrations. If the civilians uphold the current regime's IMF stabilization program, we judge they probably will be forced to limit tax breaks, subsidies, and financial offerings to exporters. Some Brazilian authorities, according to reliable sources, have expressed particular concern about the detrimental impact that reduced availability of official financing might have on exports, especially those of agricultural goods. We believe Brasilia will need to continue aggressive foreign exchange adjustments, hold down labor costs, and intensify overseas marketing efforts to keep expanding its access to foreign markets. []

The transfer of political power will also encourage a more vigorous and contentious economic policy debate. Emboldened by new opportunities to influence public policy, we expect a number of businessmen, academics, and politicians to advocate a shift to a more domestic-market-oriented growth strategy. In their view, reported by the Brazilian press, the IMF stabilization program has not effectively reduced inflation, has incurred intolerable social costs through

unemployment and depressed incomes, and has transferred much too great a share of national resources abroad. They maintain that, with appropriate government stimulants, a large thriving domestic market would enable the country to return to rapid growth and reduce dependency on export markets. Although we judge that this argument has been rejected by most Brazilians of authority, it could gain increased support if the economy does not show sufficient growth. []

Prospects

The Near Term

On the bases of US Embassy reporting, we judge that Brazil's new civilian government—whether led by the government party nominee Paulo Maluf or opposition candidate Tancredo Neves—probably will adhere to the broad economic policy guidelines of the current regime. The candidates are promising to be more responsive to swelling popular pressures for improved economic conditions and probably will ease some especially sensitive elements of this government's austerity package, such as wage controls. Both, however, are widely reputed to be pragmatic on economic issues and will want to avoid radical policy changes and a break with the IMF. Against a projected \$12 billion in net interest payments for 1985, we expect the new government to continue to adjust exchange rates in line with domestic inflation, to sustain anti-inflationary fiscal policies, to oppose excessive wage increases, and to provide tax and financial incentives to exporters. We believe, also, that the civilian administration will embrace the present regime's moves to lift government limits on exports of some major agricultural products such as soybeans and cotton to take advantage of higher foreign prices. []

By following these policies, and barring unexpected weather-induced losses to the agricultural harvest or large-scale resort to trade restriction, we believe—and most major economic forecasting services agree—the prospects are good that Brazil will record another strong export performance in 1985. According to this

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view, Brasilia probably would boost exports some 10 percent to \$29 billion next year, supported largely by continued recovery in many of the industrialized countries and some revival of demand in developing countries as Third World governments increasingly stress restored growth of their economies.² A notable exception to the above view is taken by Data Resources Incorporated (DRI) which holds that export growth will be sluggish because of a major slowdown in the US economy and a hefty rebound of Brazil's domestic demand. []

We believe industrial products will account for most of next year's export growth, but primary product sales should rise somewhat as well. For example, the press reports that shipments scheduled to commence next March to Europe and Japan from the billion-dollar Carajas mineral project in the Amazon probably will enable Brazil to increase its iron ore earnings in 1985 by 20 percent to nearly \$2 billion. Moreover, the recent disastrous infestation of citrus canker in Florida may assure Brazil of a second banner year for orange juice exports even larger than that of 1984. []

This favorable export scenario, in our opinion, would permit Brazil to achieve a \$12.5 billion trade surplus in 1985, while substantially reducing its new foreign financing needs and facilitating a return to economic growth. A surplus of this magnitude would substantially exceed Brazil's net interest payments and—because principal repayments probably will be re-scheduled to later years—might prompt the government to lower its requests for new money to less than a third of the \$6.5 billion raised this year. Similar to 1984, the export drive also would be likely to prop up Brazil's industrial plant utilization in the face of sluggish domestic demand and stimulate increased investment. Numerous economists inside and outside of Brazil expect that these trends probably will engender a rise in national output of at least 3 percent and a corresponding drop in unemployment in 1985. []

Beyond 1985

While the export picture at present looks good through next year, opinions vary widely among Brazilian and foreign observers as to the country's longer term prospects. The financial press indicates that some observers question whether Brazil can generate sufficient export growth to overcome its severe foreign debt difficulties in this decade while maintaining acceptable domestic economic growth. In order to determine these prospects and the tensions Brazil might face, it is important to assess both export needs and export capabilities. []

Export Requirements. Brazil's financial difficulties for the most part reflect its poor creditworthiness and the reluctance of foreign banks since early 1982 to provide it large new loans. According to various intelligence sources, foreign banks will not voluntarily resume major lending to Brazil until foreign payments and domestic economic performance are stabilized. Based on our conversations with bankers, we have defined the conditions of foreign payments stabilization essentially as the elimination of the current account deficit within three years. By doing so, Brazil can begin to repay its principal by means of moderately sized new borrowings and to level off its overall outstanding foreign debt. Our current account calculations shown in Table 5 suggest that with Brazilian growth at 4 to 5 percent exports must rise at more than an annual average rate of 10 percent if the government is to balance its current accounts by 1987. []

Export Capabilities. We believe Brazil will be in a competitive position with regard to expanding export markets so long as it continues its aggressive currency devaluations and restraints on wage increases. Past investments will give the industrial export base a breadth, diversity, and adaptability conducive to rapid growth. Moreover, we believe Brazilians will be responsive to market incentives, and enhanced profitability will spur export of items that have yet to penetrate foreign markets to a significant degree. []

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Table 5
Brazil: Projected Export Requirements

Billion US \$

	1985	1986	1987	1988	1989
Current account balance	-2.5	-1.0	0	0.5	1.0
Services balance ^a	-15.0	-15.5	-16.0	-16.0	-15.5
Trade balance	12.5	14.5	16.0	16.5	16.5
Oil imports ^b	5.5	6.0	6.7	7.3	8.1
Nonoil imports ^c	11.0	13.5	14.9	16.6	18.4
Required exports	29.0	34.0	37.6	40.4	43.0

^a The services balance is influenced predominantly by net interest payments, which rise through 1987, stabilize in 1988, and begin to fall in 1989.

^b Energy imports drop in 1985 as a result of continued increases in domestic oil production. Thereafter, we assume a leveling off of production, constant demand for imports, and average annual price increases of 10 percent.

^c In 1986, nonoil imports assume a value equal to 4.5 percent of expected GDP. Although slightly below ratios of the 1970s ranging from 4.6 percent to 5.0 percent, the 1986 relationship represents a substantial increase from the recession years of 1981-84. Thereafter, imports grow at an income elasticity of 1.0 for domestic growth—projected at 4 percent annually during 1985-87 and 5 percent annually in 1988 and 1989—adjusted for a projected annual average inflation rate of 6 percent. In 1988, an additional small increase reflects a 3.0 elasticity for the change in the growth rate.

According to technical publications, industrial country importers already are eyeing Brazilian fashions, jewelry, and other consumer products. Brazil may succeed in establishing an export capability for certain high-technology products, such as semiconductors or telecommunications equipment, although we doubt this could materialize before late in the decade.

Production of other well-established industrial export items such as automobiles is slated to expand substantially. The extensive investment and modernization that has been undertaken recently by the subsidiaries of multinational automakers and the recent integration of these subsidiaries into the production of world cars and trucks—such as the Ford Escort now produced mainly in Brazil—signals a major increase in auto exports to industrialized as well as developing country markets. According to the press, US and European auto company executives view their Brazilian operations as a significant new base for competition with Japan.

Even if commodity prices fail to rebound, prospects for some increase in primary product exports over the second half of the 1980s should be possible because of large investment programs launched in the 1970s. Forestry projects in the Amazon basin, which contains 35 percent of the world's tropical forest reserves, should lead to rising tropical wood exports. Commercial export-oriented farming projects in the cerrado, a vast undeveloped savannah in the central and western part of Brazil, have shown extremely promising early results. For example, shipments of cerrado soybeans for foreign markets began in June 1984 and are expected to reach 500,000 tons annually in the coming years, according to government officials. The startup of large mining projects in the Amazon—the Carajas complex alone holds the largest and richest iron ore deposit in the world—is expected to yield considerable increases in exports of iron ore, manganese, and bauxite later in the decade, according to press reporting.

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Table 6
Brazil: Export Forecasts

Billion US \$

	1984	1985	1986	1987	1988	1989
Data Resources Incorporated	25.2	27.6	29.8	32.4	35.3	38.9
Chase Econometrics	26.8	28.9	31.5	34.3	38.0	42.7
Evans Economics	25.7	29.9	33.1	36.5	40.3	NA
Wharton Econometrics	26.4	29.1	30.9	34.4	38.5	42.5
CIA	26.0	28.6	32.0	35.9	40.3	45.4

We believe that Brazil, under favorable global economic conditions, should be able to expand its exports substantially more than 10 percent a year through the end of the decade. A CIA simulation model shows that Brazil could sustain annual export growth rates averaging 12 percent, assuming average annual world economic growth of at least 3 percent and no major shocks to the world economy. Similar baseline projections for the period 1985-89 by reputable econometric forecasting services generally substantiate this assessment, with projected export gains of at least 10 percent (table 6). [REDACTED]

An Unfavorable Alternative

Despite our cautious optimism, we see some risks for Brazil, both international and domestic. From an international perspective, there is an appreciable possibility that another worldwide recession might intervene. In our judgment, a substantial sag in foreign demand beginning in 1985 or 1986 and lasting two years could cut the annual rate of growth of Brazilian exports in half during 1985-89. Domestically, the next civilian president may change the policy course and deemphasize exports if economic conditions in Brazil do not improve markedly or, indeed, worsen. The government party nominee's weak popular support and the opposition candidate's ties to leftist groups could drive either to take more drastic steps if external pressures become impossible to manage. Persistent high inflation and low growth reinforced by foreign forces might prompt the new president to abandon austerity in favor of a different, more expansionary strategy. As an alternative means of combating inflation, for example, the government could slow the pace

of cruzeiro devaluations or increase export taxes to contain budget deficits. To spur growth, it might stimulate domestic demand and raise wages. Any of these measures clearly would undercut the goal of facilitating export growth. [REDACTED]

In the event that a combination of international and domestic factors caused a substantial fall in export earnings, Brazil would not come close to generating enough foreign exchange to fulfill its debt payment commitments, bank creditors would balk at requests for new loans, and Brazil's financial position would unravel badly. Under such conditions, we believe only a major debt relief program—perhaps extending over 20 years and involving some form of interest capitalization—would keep Brazil afloat financially and in good standing with the international trading community. [REDACTED]

Implications for the United States

Judging from public statements, high-level officials in Brasilia appreciate the vital US role in boosting Brazilian manufactured exports in 1983 and 1984. Based on Brazilian trade statistics, exports to the United States, which rose 25 percent in 1983 contributing to a \$2.6 billion bilateral trade surplus for Brazil, probably will rise another one-third this year. Prospects that the United States will continue to absorb increases of this magnitude, however, are small, and Brasilia has publicly acknowledged it. [REDACTED]

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Driven by the need to service their debt, the Brazilians have been unusually sensitive to signs of emerging protectionist trends in the United States, as well as other industrialized countries. When Washington determined this past spring that Brazilian carbon steel export subsidies were hurting US industry and approved countervailing duties, Brazil reacted with indignation. In addition to Brasilia's decision to restrain voluntarily its steel exports to the United States beginning 1 May 1984 in order to persuade Washington to eliminate the duties, some Brazilian officials have threatened retaliation. Brazil and the United States presently are attempting to agree upon a steel export quota, but differences remain substantial.

According to the US Embassy, potential US actions against Brazilian exports in other product areas—such as textiles, shoes, alcohol, tobacco, poultry, and soybeans—could cause additional frictions. An ITC ruling this summer favorable to the Brazilians with respect to footwear sales to the United States, however, has improved the climate. Brazil also is optimistic it can overcome US trade barriers to the importation of its alcohol. Because Brazil will have to continue running trade surpluses, the United States and other industrialized countries will be able to increase sales to Brazil only by continuing to expand imports from Brazil.

At the same time, a heightened Brazilian sales drive in third-country markets will present stiffer competition for US exporters. Recent press reports indicate that the Brazilian Government is concerned about what it perceives to be overdependence on the US market and plans to campaign more vigorously for expanded sales to Western Europe, Asia, and the Middle East. A wide array of US exports to these markets could be affected, ranging from soybeans and frozen chicken to small aircraft.

Brazilian export trends probably will have significant direct and indirect implications for US foreign investment. As Brasilia intensifies its export drive, we believe it will continue to offer greater inducements to foreign firms to establish export operations in Brazil.

More US firms may find that Brazil—especially if the next government maintains prudent exchange rate, wage, and fiscal policies—will become an increasingly attractive production export base, especially for sales to the Third World. In addition, export successes, by contributing to a financially stronger economy and the restoration of substantial GDP growth, will make Brazil considerably more appealing to US and foreign firms that wish to make new investments to produce for local markets.

A failure to expand exports rapidly probably would hurt the financial positions of many US creditors. US banks, which hold nearly one-quarter of Brazil's \$100 billion in foreign debt, are extremely vulnerable to the debt servicing disruption that almost certainly would follow any serious setback in Brazil's efforts to earn foreign exchange. We believe many US banks would incur appreciable losses if faltering exports forced even a temporary Brazilian moratorium on debt payments. Some probably would choose to write off substantial portions of their loans to Brazil, resulting in larger losses.

From a broader perspective the ramifications of a Brazilian export drive goes well beyond the impact that one country's international trade accounts have. Many other major debtor countries in South America and elsewhere are being urged by their international creditors to strengthen their debt service capabilities through substantially enlarged export earnings. To some extent, therefore, Brazilian gains will come at the expense of other debtors who are not as well positioned to sell abroad. These other countries often lack the broad industrial base Brazil enjoys; in some cases, they are highly dependent on a small number of products—such as copper, coffee, or oil. Regardless of the cause, the situation would only be compounded if Western economic growth were to sputter in the years ahead.

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